USA COALITION

Universal Service for America Coalition

A New Approach to Universal Service Reform

The Foundation for a New Approach

- The universal service provisions of the Act require the FCC to ensure that Americans living in "rural, insular and high-cost areas" have service options "reasonably comparable" to those available in "urban areas"

- The best way to achieve universal service and to foster the deployment of the fastest and most efficient services is to focus on removing the obstacles that service providers face in unserved and underserved areas

- Two primary obstacles impact all types of technologies – apart from satellite – and all types of competitors – ILECs and CETCs (collectively, "ETCs"), regardless of data transfer rates:
  - **Low population density** (*i.e.*, fewer subscribers from whom to recover costs)
  - **Higher cost of service** due to harsh terrain (*e.g.*, mountains, swamps, volcanic rock, tundra, lack of access), population distribution issues (*e.g.*, longer and more expensive backhaul) and other issues

- The New Approach addresses these two primary obstacles directly so that universal service support funding will be more effective
  - By addressing the primary obstacles directly, the new approach eliminates artificial distinctions based on technology (*e.g.*, wireline or wireless), competitive status (*e.g.*, ILEC or CETC), or current speed of service (*e.g.*, "broadband" or "narrowband")

- Setting arbitrary requirements with respect to speed or type of service will only inhibit the deployment of both broadband and voice services in rural areas

Summary of the New Approach

- The FCC would identify areas where support is necessary from the perspective of the consumer ("Supported Areas")
- Support is necessary wherever Americans living in "rural, insular and high-cost areas" lack access to service options that are "reasonably comparable" to those available in "urban areas" in terms of relevant characteristics as defined by the Commission
- In each Supported Area, the FCC would calculate the amount of necessary support
  - The FCC would calculate a "Reimbursement Percentage" for each Supported Area to reflect the percentage by which the cost to serve each potential subscriber in the Supported Area exceeds the cost to serve each potential subscriber in an Average Urban Area
- ETCs would be reimbursed for all eligible expenditures (*i.e.*, CapEx & OpEx) made to serve the Supported Area based upon the Reimbursement Percentage for the Supported Area
- The New Approach would be phased in over a 10 year period

Identifying Areas Where Support Is Needed

- The FCC would divide the country into technologically neutral and publicly established "USF Areas" (*e.g.*, counties, zip codes, census blocks or islands)
- The FCC would identify and quantify the characteristics of an average urban market from the perspective of the retail consumer
- The FCC would compare the characteristics of each USF Area with the characteristics of the Average Urban Area
- A USF Area would be designated as a "Supported Area" if the characteristics of the area are not "reasonably comparable" to any **one** of the identified characteristics of the Average Urban Area
- The FCC would reevaluate each USF Area on regular intervals (*e.g.*, every five years) to update the list of Supported Areas

Calculating the Amount of Support Provided: The Goal of the Reimbursement Percentage

- The goal is to determine the amount of support necessary to make the service cost per potential subscriber in a Supported Area "reasonably comparable" to the service cost per potential subscriber in an "average urban area," so ETCs would be allowed to recover
  - the percentage of costs incurred to serve a Supported Area equal to the percentage by which the average cost to serve the Supported Area exceeds the average cost to serve the Average Urban Area (the "Cost Factor"); plus
  - the percentage of the remaining costs equal to the percentage by which the population density of the Average Urban Area exceeds the population density of the Supported Area (the "Population Density Factor")

- The FCC would calculate a single Reimbursement Percentage for each Supported Area
  - The Reimbursement Percentage would reflect the combination of the Cost Factor with the Population Density Factor

- The FCC would calculate the amount of support an ETC receives by multiplying the eligible expenses incurred by the ETC to serve a Supported Area by the Reimbursement Percentage for that Supported Area

Calculating the Amount of Support Provided: The Reimbursement Percentage

- The Reimbursement Percentage is designed to place each individual ETC serving a Supported Area in a position that is reasonably comparable to what it would encounter if serving the Average Urban Area

- The Reimbursement Percentage would not change the competitive position of any ETC serving a Supported Area vis-à-vis any other ETC serving the same area

- Support should be sufficient to create the same incentives and disincentives for carriers serving rural, insular and high cost areas that they would face in urban areas

Calculating the Reimbursement Percentage: The Cost Factor

- The FCC would calculate one cost factor for each Supported Area
- The cost factor reflects the percentage, on average, that the cost (CapEx & OpEx) to serve a particular Supported Area exceeds the cost to serve the Average Urban Area
  - The goal is to determine the percentage by which the total cost a particular service provider would incur to serve the Supported Area exceeds the total cost that same provider would incur to serve the Average Urban Area (assuming equal population densities)
- Rather than attempting to determine the actual cost to serve, the FCC instead would seek only to determine the relative differences in costs to serve
  - The FCC could achieve this by comparing specific cost proxies (*e.g.*, relative cost of backhaul) or using cost models

Calculating the Reimbursement Percentage: The Population Density Factor

- The FCC would calculate one Population Density Factor for each Supported Area
- The Population Density Factor reflects the percentage by which the Supported Area has a lower population density than the Average Urban Area
  - As population density decreases, the cost to serve potential subscribers increases because there are fewer potential subscribers across whom to distribute costs
- The FCC would determine the population density in the Average Urban Area, and then calculate a single Population Density Factor for each Supported Area based upon publicly available census data

Identification of Costs Eligible for Reimbursement

- The FCC would define classes of expenditures eligible for reimbursement as eligible costs
  - Examples of eligible costs would include equipment costs, backhaul costs, and spectrum acquisition
- The FCC would adopt clear rules regarding attribution of expenditures to Supported Areas
  - Expenditures that service multiple Supported Areas, or that service both Supported Areas and unsupported areas, would be allocated to each area based on line count
- All eligible costs would be reimbursed based upon the Supported Area's Reimbursement Percentage

Calculating Support: An Example

- Assume the FCC makes the following determinations for a Supported Area:
  - **Cost Factor = 25%:** The average cost to serve the Supported Area is 25% higher than the average cost to serve the average urban area
  - **Population Density Factor = 55%:** Census data indicates that the population density in the Supported Area is 45% of the population density in the average urban area (*i.e.*, a 55% difference between the Supported Area and the Average Urban Area)

- With these determinations, the reimbursement an ETC would receive for each $100 of eligible expenses it incurs to serve the Supported Area would be calculated as follows:
  - First, the FCC would apply the **Cost Factor** to the full $100 of eligible expenses, which results in a reimbursement of $25 (*i.e.*, 25% of $100 = $25)
  - Second, the FCC would apply the **Population Density Factor** to the remaining $75 of unreimbursed eligible expenses, which results in an additional reimbursement of $41.25 (*i.e.*, 55% of $75 = $41.25)
  - In sum, the ETC would receive a total reimbursement of $66.25 ($25 + $41.25) for each $100 of eligible expenses it incurs to serve the Supported Area

- The Cost Factor and Population Density Factor can be combined into a single Reimbursement Percentage unique to each Supported Area
  - In this example, the **Reimbursement Percentage** would be 66.25%

The Reporting and Reimbursement of Eligible Costs

- The Commission would require ETCs to:
  - Follow standard accounting rules (*e.g.*, GAAP) **or** accounting rules otherwise mandated by a regulatory authority
    - No ETC would be required to implement unnecessary accounting rules merely to participate in the universal service program
  - File simple reimbursement requests on a quarterly basis that identify, by Supported Area:
    - total expenditures eligible for reimbursement; and
    - the general type of and class of each expenditure
- Carriers would be able to determine the amount of money they should receive for eligible CapEx or OpEx prior to incurring those costs
- To provide support for broadband, the USF administrator needs only to define additional types and classes of eligible expenditures
- The New Approach moves carriers away from historical or projected costs and reimburses carriers based on actual, incurred costs

Advantages of the New Approach

- The New Approach would focus on consumers and eliminate obstacles that prevent consumers in rural, high cost and insular areas from enjoying the diversity of service and lower prices available in urban areas

- ILECs and CETCs would compete for subscribers on a level playing field, and succeed or fail based upon consumer demand for their products and services, which would facilitate consumer choice

- Support would be distributed based upon the costs that ILECs and CETCs actually incur, and every ILEC and CETC serving a particular Supported Area would be eligible for reimbursement of the same percentage of those costs

- Eligible costs would be clearly defined and easily auditable, and the increased transparency at the beginning of the process would reduce the need for complex and burdensome audits

- ILECs and CETCs would know exactly how much support they would receive before they make decisions regarding network or service expansion

- The new approach would provide support for all types of services and service providers, regardless of technology, speed, or provider type

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Questions?

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